

Mossberg's Investor Digest

From the Editor...

Thank you for your subscription to Mossberg's Investor Digest.

Headquartered in Seattle, 46-year-old **Data I/O Corporation (Nasdaq: DAIO)** is the largest provider of systems and services that are used to program integrated circuits. Their technology securely programs the little black "chips" on circuit boards used in automotive electronics, medical devices, consumer electronics, industrial controls, internet connected devices and other markets.

DAIO offers an interesting way to invest in the themes of the "electronification of the automobile" and the proliferation of internet connected devices, or "IoT". While relatively small, DAIO's served addressable market is expected to double from \$100 million in 2016 to \$200 million by 2020, primarily through secular growth in these investment themes. DAIO is already benefiting from the growth of electronics used in cars with 54% of 2017 bookings related to the automotive end market. And, DAIO is making significant investments in its SentiX security platform that should position it to be a leader in the IoT market.

Stronger than expected growth in 2017 and the whipsaw affect in 2018 have led to a roller coast ride in the stock price from \$4 at the beginning of 2017 to a peak of \$15 and back to recent levels. Expectations have been reset and growth should resume in 2019. At current prices, we believe the stock offers an attractive risk/ reward profile with downside protection supported by nearly \$2.00 per share in cash. Our back of the envelope calculation yields 50% upside in the next 12-18 months. For longer term shareholders, we believe there is even more upside.

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Issue #122

Every month we hear ideas suggested from our large network of professional investors. Here are a few of the ideas we heard this month.

RigNet, Inc. (Nasdaq: RNET) - Is a global technology company that provides customized communications services, applications, real-time machine learning, and cybersecurity solutions to enhance customer decision-making and business performance. RigNet delivers a digital transformation bundle that accelerates technology adoption and empowers customers to be always connected, always secure, and always learning.

Magnolia Oil & Gas Corporation (NYSE: MGY)- Is an independent oil producer with assets located in the Eagle Ford Shale and Austin Chalk formations in South Texas. Their objective is to maximize shareholder returns by generating steady production growth, strong pre-tax margins, and significant free cash flow. Magnolia was formed in 2018 through the business combination of EnerVest's South Texas Division and TPG Pace Energy, a Special Purpose Acquisition Company (SPAC) formed by Steve Chazen, our Chairman and CEO, and TPG Capital. Magnolia is headquartered in Houston, Texas.

Tuesday Morning Corporation (TUES) - is leading closeout retailer of upscale home furnishings, housewares, gifts and related items sold in the US. The company operates 857 stores in 45 states, which are generally open seven days a week and focus on periodic "sales events.". Tuesday Morning purchases quality, brand name merchandise at closeout pricing and sells it at prices significantly below those generally charged by department stores and specialty and catalog retailers. The company's customer base is primarily women from middle to upper-income households who are brand savvy, value-conscious customers seeking quality products at discount pricing. This merchandise is then offered at attractive prices.

Intevac, Inc. (Nasdaq: IVAC) - Is a leader in the design and development of high productivity, thin film processing systems. They are the market and technology leader in the hard drive industry. Their technology solutions improve performance and throughput, and continue to expand into additional markets – including solar and adjacent thin film deposition applications. They are also a recognized leading developer of advanced high-sensitivity digital sensors, cameras and systems that primarily serve the defense industry. They are the sole source provider of integrated digital imaging systems for most U.S. military night vision programs.

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Best Idea Profile:

Data I/O Corporation (Nasdaq: DAIO)

DESCRIPTION:

Headquartered in Seattle, 46-year-old **Data I/O Corporation (Nasdaq: DAIO)** is the largest provider of systems and services that are used to program integrated circuits. Their technology securely programs the little black "chips" on circuit boards used in automotive electronics, medical devices, consumer electronics, industrial controls, internet connected devices and other markets.

Key value propositions of DAIO's technologies are 1) automating the installation of these programs, 2) the speed in which large program files can be provisioned and 3) security that helps to thwart the increasing threat of IP theft and/or system hacking.

DAIO offers an interesting way to invest in the themes of the "electronification of the automobile" and the proliferation of internet connected devices, or "IoT". While relatively small, DAIO's served addressable market is expected to double from \$100 million in 2016 to \$200 million by 2020, primarily through secular growth in these investment themes. DAIO is already benefiting from the growth of electronics used in cars with 54% of 2017 bookings related to the automotive end market. And, DAIO is making significant investments in its SentiX security platform that should position it to be a leader in the IoT market.

Approximately 70% of sales are tied to equipment, which has historically made revenue comparisons lumpy, as well as susceptible to the cyclical ups and downs of the semiconductor equipment market. Case in point, revenue and earnings comparisons for 2018 will be negative, as customers ramped up equipment spending last year and have temporarily pulled back while new capacity is being absorbed. Near-term financial comparisons have also been challenged by R&D investments in the Company's new

Data I/O Corporation (Nasdaq: DAIO) Investment Data (as of 8/30/18)

Recent Price	\$5.37
52-Week Range	\$4.88 - \$16.49
Fiscal Year End	December
Dividend	\$1.00
Yield	N/A
Shares Outstanding	8.4 M
Average Trading Volume (3 mos)	60,000
Market Capitalization	\$45M
Cash & Equivalents	\$17M
LT Debt	-
Enterprise Value (EV)	\$27M
TTM Revenue	\$33 M
EV/ Revenue	0.8x
2017 EBITDA*	\$4.6 M
EV/ EBITDA	5.9x

SentiX security provisioning platform. Importantly, SentiX is being sold with a "pay per use" model, which will likely mean a slower ramp in revenue, but more recurring and predictable revenue comparisons in the future.

Stronger than expected growth in 2017 and the whipsaw affect in 2018 have led to a roller coast ride in the stock price from \$4 at the beginning of 2017 to a peak of \$15 and back to recent levels. Expectations have been reset and growth should resume in 2019. At current prices, we believe the stock offers an attractive risk/ reward profile with downside protection supported by nearly \$2.00 per share in cash. Our back of the envelope calculation yields 50% upside in the next 12-18 months. For longer term shareholders, we believe there is even more upside.

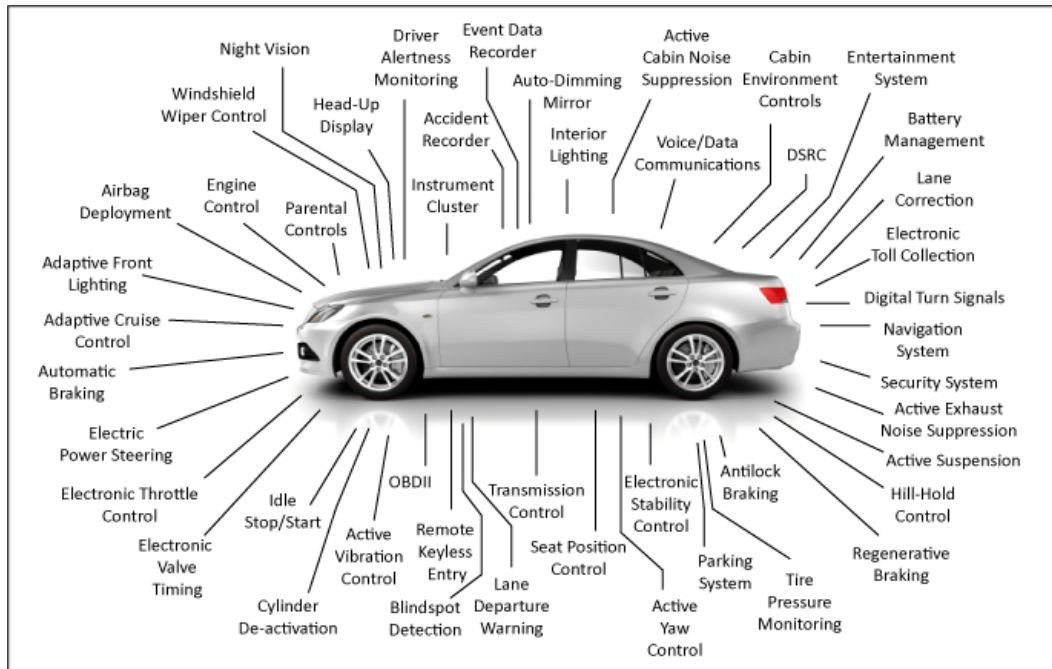
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KEY INVESTMENT CONSIDERATIONS:

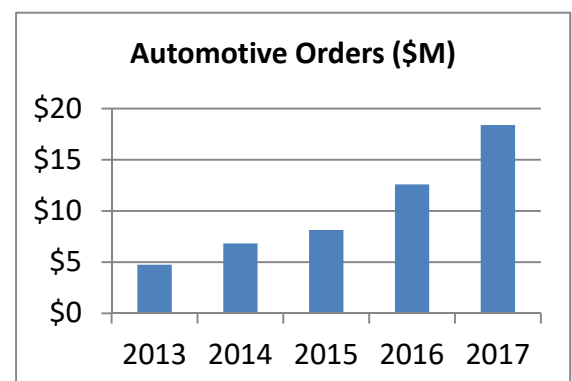
Secular Growth Driver - The Electronification of the Automobile



Electronification of autos impact on programing demand - Industry forecast from leading automotive OEMs indicate a 10% to 15% annual growth rate for semiconductor content in cars, and a larger increase of about 30% compounded annual growth in the total market for flash memory in cars, growing to about 1 terabyte, or more, of flash memory in the next 7 to 8 years.

- According to The Clemson University Vehicular Electronics Laboratory, a typical automobile on the road today has over 50 computer controlled electronic systems.
- PwC analysts expect nearly 470 million connected cars to be on the road in the U.S., the E.U. and China by 2025.
- According to IC Insights, annual auto chip sales will nearly double, from \$22.9 billion in 2016 to \$42.9 billion in 2021.

DAIO has become a clear leader in the automotive space and has already seen significant growth in programing demand from the automotive market. Due to a strategic focus and investment in the automotive vertical, during the past five years the company has more than doubled its revenue base. DAIO is now working with 8 of the top 10 auto electronics companies and the top five auto programming centers. Automotive now represents over half of revenue and programming centers represent about 1/4 of revenue.

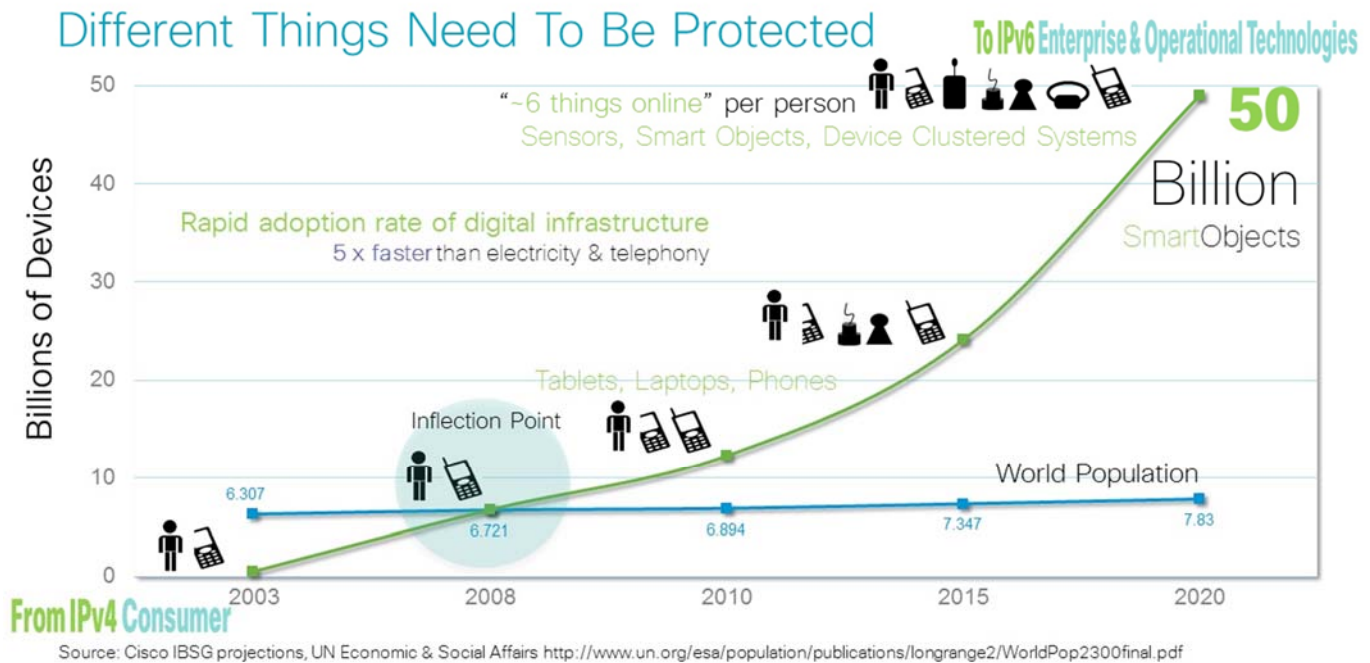


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KEY INVESTMENT CONSIDERATIONS:

Secular Growth Drivers - The Growth of Internet Connected Devices



IoT's impact on programing demand

$$\text{Programming Demand} = \text{Units} \times \text{Bits} \times \text{Security}$$

- **Unit Growth** – The growth of Internet connected devices has already begun and will only continue to accelerate. There are about 6 devices connected to the internet per person on earth. The number of connections is expected to grow dramatically over the next several years. According to Cisco, the number of devices will grow to 50 billion by 2020 and to 500 billion by 2030.
- **Bit Growth** – As customers want these devices to do more and more things the size of the code programmed on the device will grow. For example, according to Mercedes-Benz, the requirement for flash content per car will grow to more than 1 Terabyte by 2025, which represents a 20x increase relative to 2017.
- **Security Importance** – As more devices are capable of connecting to the internet, the programming code on the circuitry is susceptible to hacking and/or IP theft. The opportunity for Data I/O is to simplify the security provisioning process and make solutions available to customers of all sizes.

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KEY INVESTMENT CONSIDERATIONS:

Investment in Security Platform

We estimate that the company has invested about \$5 million of incremental R&D spending over the past 18 months to develop its new StentriX security provisioning platform. This investment began in 2017 and has continued through the launch of the first platforms earlier this year.

Security provisioning is a big opportunity for IoT - According to ABI research, the addressable market for security provisioning will grow to 5 billion units by 2022. Based on the investment, experience and track record in its existing markets, we believe the Company has a good chance of capturing a good portion of this rapidly growing market.

Change in revenue mix... more recurring and predictable – Approximately 70% of revenue is derived from systems sales, which can be lumpy in nature and cause significant swings in revenue comparisons from quarter to quarter and year to year. The remaining 30% of revenue is recurring and is derived from adaptors that need to be replaced every 3-24 months and from software and maintenance revenue. Management has decided to launch StentriX as a “pay-per-use” model, which could expand the base of recurring revenue significantly in the coming years. We expect that a more predictable and recurring revenue stream could create higher valuation multiples for the stock.

Creating a partner ecosystem to gain market share in security provisioning – In the past year, the Company has announced several partnerships with leading silicon suppliers, leading tool providers, and security software suppliers. Below are the announced partners from the investor presentation.



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Valuation

	2017	2018	2019	2020
Revenue	34.1	29.3	32.8	36.8
Growth Rate	45%	-14%	12%	12%
Cost of Sales	14.0	12.2	13.3	14.5
Gross Profit	20.1	17.1	19.5	22.2
Gross Margin	58.9%	58.5%	59.5%	60.5%
R&D	6.9	7.6	8.1	8.5
SG&A	8.1	8.2	8.6	9.2
Stock comp	0.7	1	1	1
Depreciation	0.8	1	1	1
Adj. EBITDA	6.7	3.4	4.8	6.5
Adj. EBITDA Margin	19.7%	11.6%	14.7%	17.8%
CAPEX	2.2	2.2	2.2	2.2
Free Cash Flow		1.2	2.7	4.4
Cash	18.5	19.7	22.4	26.8
EV/EBITDA Multiple			9	9
Enterprise Value			43.5	58.8
Market Cap			65.9	85.6
Shares Outstanding	8.4	8.4	8.4	8.4
Share Price			\$7.84	\$10.20

Our back of the envelop model above makes the following assumptions:

Revenue: We expect a 2018 will decrease by 14% to \$29.3 million, which reflects a pause in orders after exceptionally strong growth during 2017. Averaging the growth from 2017 and expected decline in 2018, our revenue expectation for 2018 reflects an annual growth rate of 12% over the two-year period from 2016 to 2018. We conservatively estimate 12% growth for each of the next two years

Gross Margin: We assume 58.5% gross margin during 2018, which is consistent with the performance year to date. Thereafter, we assume a one percentage point improvement per year, which reflects growth of the SentiX security provisioning platform, which pay-per-use model should command premium pricing and margins.

R&D and SG&A: For 2018, we assume that spending on R&D and SG&A will continue at their current run rate for the balance of the year. Thereafter, we assume these expense items will grow at approximately half the pace of revenue growth.

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Valuation (cont'd)

Stock Comp and Depreciation: We estimate \$1 million for each of these expense lines, which approximates current spending levels

EBITDA Margin: Our model shows 620 basis point of improvement over the next two years as incremental sales are levered over the fixed costs of the business. EBITDA margin improves to 17.8% of sales by 2020. This level may prove to be conservative considering the company produced 19.7% EBITDA margin in 2017.

Capex & Free Cash Flow: We use EBITDA as a proxy for operating cash flow and net out \$2.2 million in annual capex spending to generate a free cash flow estimate.

Valuation: We use a 9x multiple of 2020 EBITDA to derive an enterprise value of \$59 million in 2020. While peer EV/EBITDA multiples are in the range of 10x to 12x, we use a discounted multiple to reflect the company's size. Working backwards from enterprise value, we calculate a share price of \$10.20 per share in 2020, which represents 85% upside from current levels.

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Mossberg's Investor Digest Idea Performance

The table below shows the relative change in the value of the ideas published since January 2016 and the Russell 2000. **Performance data quoted represents past performance and does not guarantee future results.** Current performance of ideas may be lower or higher than the performance quoted.

Company	Pub. Date	Original Price	Recent Price	Change	Russell 2000 Change Since Pub. Date	Relative Perf. vs. Russell 2000	
Dycom Industries, Inc (NYSE: DY)	31-Jan-16	\$62.18	\$78.28	25.9%	66.7%	-40.8%	
Rackspace Hosting, Inc. (NYSE: RAX)	29-Feb-16	\$21.54	\$32.00	48.6%	66.9%	-18.3%	
Kopin Corporation (Nasdaq:KOPN)	31-Mar-16	\$1.66	\$2.29	38.0%	54.9%	-17.0%	
PAR Technology Group (NYSE: PAR)	30-Apr-16	\$6.39	\$23.54	268.4%	52.6%	215.8%	
Full House Resorts Inc. (Nasdaq: FLL)	30-May-16	\$1.60	\$3.00	87.5%	50.0%	37.5%	
Control4 Corporation (Nasdaq: CTRL)	30-Jun-16	\$7.99	\$36.72	359.6%	49.8%	309.8%	
KapStone Paper and Packaging Corporation (NYSE: KS)	31-Jul-16	\$14.28	\$34.34	140.5%	41.5%	99.0%	
Ampco-Pittsburgh Corp. (NYSE: AP)	31-Aug-16	\$11.12	\$8.00	-28.1%	39.2%	-67.2%	
Select Comfort Corporation (Nasdaq: SCSS)	30-Sep-16	\$22.51	\$32.50	44.4%	37.9%	6.5%	
Northwest Pipe Co. (NWPX)	31-Oct-16	\$13.16	\$17.77	35.0%	44.8%	-9.8%	
Mitel Networks Corporation (Nasdaq: MITL)	30-Nov-16	\$7.25	\$10.98	51.4%	30.5%	20.9%	
Black Box Corporation (Nasdaq: BBOX)	31-Dec-16	\$15.25	\$1.22	-92.0%	27.2%	-119.2%	
RadNet, Inc. (Nasdaq: RDNT)	31-Jan-17	\$5.80	\$14.00	141.4%	26.7%	114.7%	
Guidance Software, Inc. (Nasdaq: GUID)	28-Feb-17	\$6.60	\$7.10	7.6%	24.4%	-16.9%	
Calgon Carbon Corporation (NYSE: CCC)	31-Mar-17	\$14.25	\$21.50	50.9%	24.5%	26.4%	
LRAD Corporation (Nasdaq: LRAD)	30-Apr-17	\$1.51	\$3.40	125.2%	23.2%	101.9%	
Trecora Resources (NYSE: TREC)	31-May-17	\$10.65	\$13.50	26.8%	25.9%	0.8%	
EVINE Live Inc. (Nasdaq: EVLV)	30-Jun-17	\$1.00	\$1.30	30.0%	21.9%	8.1%	
LSI Industries Inc. (Nasdaq: LYTS)	31-Jul-17	\$8.38	\$5.40	-35.6%	21.1%	-56.6%	
Cooper Tire & Rubber Company (NYSE: CTB)	31-Aug-17	\$33.80	\$29.95	-11.4%	22.8%	-34.2%	
RealNetworks, Inc. (Nasdaq: RNWK)	30-Sep-17	\$4.78	\$3.33	-30.3%	15.7%	-46.1%	
NCI Building Systems, Inc. (NYSE: NCS)	30-Oct-17	\$15.65	\$15.50	-1.0%	15.7%	-16.7%	
TransAct Technologies, Inc. (Nasdaq: TACT)	30-Nov-17	\$13.60	\$14.55	7.0%	11.8%	-4.8%	
Regis Corporation (NYSE: RGS)	30-Dec-17	\$15.36	\$20.61	34.2%	12.4%	21.8%	
Team, Inc. (NYSE: TISI)	30-Jan-18	\$16.95	\$25.15	48.4%	9.0%	39.4%	
Andina Acquisition Corp II (Nasdaq:ANDA)	28-Feb-18	\$9.85	\$8.00	-18.8%	14.1%	-32.9%	
GSE Systems, Inc. (NYSE:GVP)	31-Mar-18	\$3.25	\$3.50	7.7%	12.8%	-5.1%	
Telaria, Inc. (NYSE:TLRA)	30-Apr-18	\$4.13	\$3.59	-13.1%	11.9%	-25.0%	
Avaya Holdings Corp. (NYSE:AVYA)	31-May-18	\$21.57	\$23.02	6.7%	5.6%	1.1%	
Tenneco, Inc. (NYSE:TEN)	30-Jun-18	\$43.96	\$44.71	1.7%	5.0%	-3.3%	
Edgewater Technology (Nasdaq:EDGW)	31-Jul-18	\$5.20	\$5.07	-2.5%	3.3%	-5.8%	
				Average	43.7%	28.1%	15.6%

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The value proposition of the digest is essentially an "Idea Generator". During the course of my 18-year career in capital markets, I've had the chance to meet and work closely with some very smart professional investors who have consistent track records of outperforming the market indexes. Some of these investors, which include mutual fund managers, hedge fund managers, and other professional investors, are kind enough to share their best ideas with me. I conduct my own analysis of their ideas and publish summaries of those ideas I think represent timely investment opportunities. Over time, I trust the majority of these ideas will pan out and help subscribers generate index-beating returns.

The goal of the Best Idea Profiles in this newsletter is to briefly describe the most relevant investment merits and risks of a company. It is not intended to be an exhaustive report including every detail. With limited space available, I am forced to include only those data points that I feel are most important for subscribers to know before they begin their own due diligence. Thank you for your interest in Mossberg's Investor Digest.

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